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ARC Alliance for Rail Competition

National Barley Growers Association

Idaho Grain Producers Association

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before
the House Transportation
Subcommittee on Railroads, Pipelines and Hazardous Materials
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Mr. Chairman and Members of this Committee, my name is Evan Hayes. I am a malting barley and wheat producer from American Falls, Idaho, chairman of the Idaho Barley Commission, immediate past president of the National Barley Growers Association (NBGA) and past president of the Idaho Grain Producers Association (IGPA). Additionally I serve on the Executive Committee of the Alliance for Rail Competition (ARC).

I am pleased to submit this testimony on behalf of the Alliance for Rail Competition (ARC), the National Barley Growers Association, the Idaho Barley Commission, Idaho Grain Producers Association, and the agricultural community. The members of the Alliance for Rail Competition include utility, chemical, manufacturing and agricultural companies and agricultural organizations. Producers of commodities as wide ranging as soybeans, dry beans, lentils, rice, wheat, peas and sugar beets all have expressed concerns similar to those I will share with you today. Together, these organizations represent growers of farm products in more than 30 states.

Barley and wheat growers know that an effective railroad system is necessary for the success of our small grains industry. However, we continue to face many problems with service and rates that are directly tied to the capacity issues that you are addressing today. Specifically, a large portion of our small grain shippers are captive to a single railroad, which exacerbates service inadequacies. Helping our nation find solutions to rail freight problems remains a top priority for all U.S. agriculture producers, and is the reason that we strongly support H.R. 2125, the Rail Competition and Service Act of 2008, which would provide a number of remedies to rail shippers.

Let me emphasize one point before I address rail capacity and service issues today. Our government has been working diligently for a number of years to open up markets for agricultural trade through bilateral free trade agreements and the World Trade Organization to facilitate a more competitive U.S. agricultural industry. However, all of this good work will have no positive effect if we cannot get our products to export points competitively with rest of the world. In today's globally competitive markets, it is alarming to realize that we are the only major world suppliers with a monopoly railroad between us and our markets which have the capability to take out all of the profit in the transaction.

Effects of Growing Rail Captivity

Since the passage of the Staggers Rail Act of 1980, the degree of captivity in many barley and wheat growing regions has increased dramatically, and America's farmers continue to experience both unreliable service and higher freight rates. We have had continuing rail equipment shortages since the railroads started aggressively consolidating and merging in the early 1990s. Producers know that increasing the breadth of crop production on farms can lead to greater efficiency and higher income, but rather than a focus on diversity, railroad companies view efficiency as hauling larger and larger movements of a single grade crop from a single origin to a single destination. Rail investment in grain movement has been shifted to the grain merchandiser and farm producer while the service level for less-than-trainload movements continues to deteriorate. We see value-added agriculture having to invest in rail rolling stock to ensure adequate equipment supply, yet when railroad service levels do not meet railroad-supplied schedules; agriculture is frequently called upon to even further increase investment in railroad rolling stock.

Twenty years ago, there were multiple transcontinental railroads servicing agricultural regions. Today, however, whole states, whole regions and now whole industries have become completely captive to single railroads as a result of many railroad mergers. In the grain industry alone there are substantial pockets of captivity in Texas, Oklahoma, Arizona, Colorado, Kansas, Nebraska, Wyoming, Idaho, South Dakota, Minnesota, North Dakota, Oregon, Washington and Montana. Because of these pockets of captivity, the cost of transporting grain can represent as much as 1/3 (or higher) of the overall price a producer receives for his or her grain. This cost comes directly from a producer's bottom line. It is important to keep in mind that producers, unlike other businesses, cannot pass their costs on; as price takers and not price makers, producers bear all transportation costs both to and from the farm and from the elevator to the processor or export terminal.

I will provide examples of how rail captivity and declining service has impacted wheat and barley producers.

Rail inadequacies fail producers in rising wheat market.

Following the grain harvest in 2007, there were more than 10 million bushels of Colorado wheat stored on the ground primarily in areas where there was a lack of adequate rail service, specifically captive branch line areas. Colorado did not experience a record crop last year but their wheat crop was above average at 87.75 million bushels. Their production was well below the all-time record crop of 134.55 million bushels produced in 1985, and the most recent high of 103.2 million bushels in 1999 and was smaller than wheat crops produced in 10 of the last 28 years. Yet millions of bushels sat on the ground because they were produced in areas served by single railroads with no rail-to-rail competition.

Since 80 percent of Colorado's winter wheat moves by rail to export position in the Gulf of Mexico and the Pacific Northwest - too far to truck - the railroads know wheat on the ground will still be there when they get ready to move it. While U.S. wheat prices were at record highs last fall and winter, many Colorado producers and elevator operators were prevented from capturing these market highs because they are located on captive rail lines and were unable to move their grain in a timely manner. One of the railroads suggested that the reason for wheat on the ground in Colorado was that wheat was not being marketed. I can assure you that simply was not the case. Grain elevator operators would not sit idling by and lose these excellent marketing opportunities unless the railroad can't or won't provide an adequate level of service. According to the Colorado Wheat Administrative Committee that this resulted in wider basis than normal and a loss of 25 to 50 cents per bushel to these Colorado wheat producers.

In addition to Colorado, wheat was stored on the ground last fall in South Dakota, North Dakota, Montana, Idaho and Washington. The reality for many of these producers and their grain elevator operators was an economic embargo, keeping them from fully participating in a higher priced wheat market due to lack of rail service.

Traditional barley markets are lost due to monopoly rail practices.

Similar rail capacity issues are experienced by the U.S. barley industry. A majority of U.S. barley production is captive to a single railroad, oftentimes leading to several economic dislocations, including the loss of traditional feed barley markets in California and the loss of malting barley markets to Canadian competitors. I will elaborate on each of these points.

Loss of traditional feed markets in the large California dairy shed.

California corn producers, in a study in cooperation with USDA two years ago showed the dominant western railroad was pushing Iowa and Nebraska corn into the California market with rates below full rail costs. The effect on California corn producers was they could not compete in their traditional feed markets just 100 miles away from their farms. The railroad push into the market also displaced Idaho barley from the California milk shed industry – a market we had enjoyed for 50 years. The railroad in question served both the Idaho markets and the Iowa, Nebraska and California markets after the completion of its last major merger. The railroad priced the Idaho barley shipments high enough to eliminate the traditional movements into California and continues these market distorting actions to this day.

Prior to the rash of Western U.S. rail mergers and the resulting loss of competition, barley easily captured 50 to 60 percent of the California dairy feed grain market, amounting to between **60 and 70 million bushels** annually. Today we are moving fewer than 50 rail cars of barley per month into the California dairy market, amounting to less than **200,000 bushels**. This represents an astounding loss in market share.

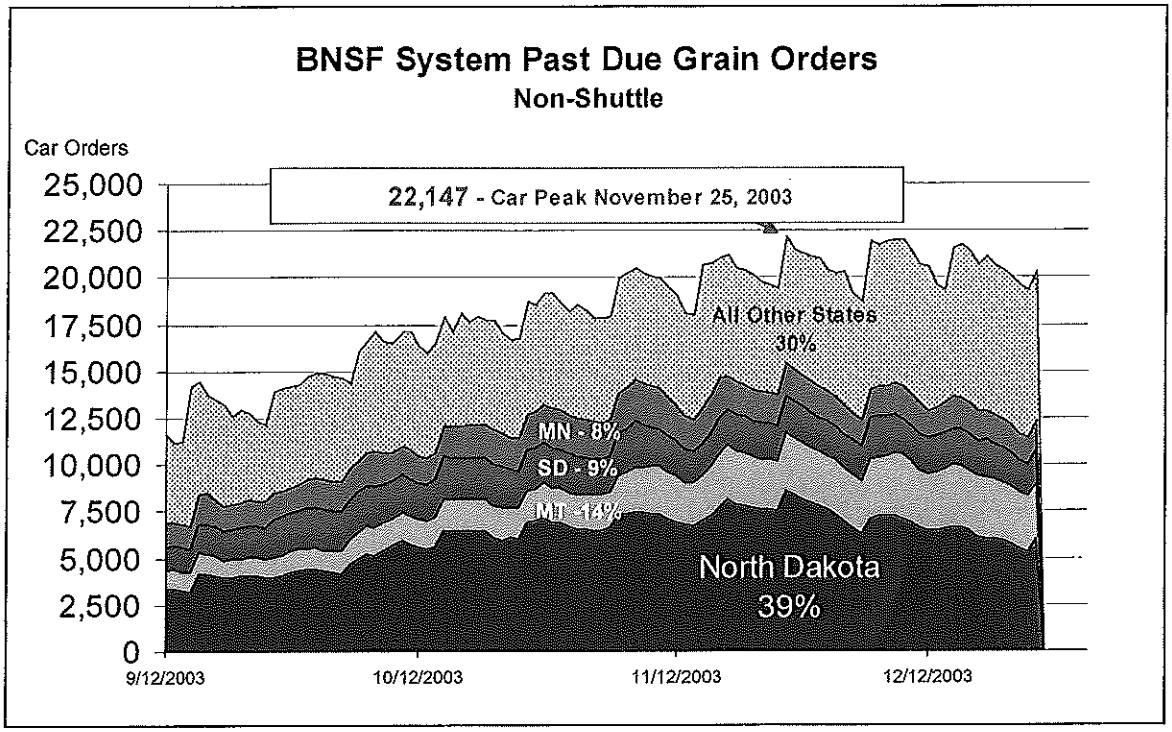
In a 2004 letter to customers, Jack Koraleski, UP Executive Vice President – Marketing and Sales, announced the railroad's unilateral decision to limit carloadings and reduce the overall inventory of railcars due to the UP's failure to have enough workers to handle growth in demand. The UP also said it was creating an allocation system to protect terminals from overload, capping the number of incremental train starts, and regulating the volume of selected agricultural commodities.

Frankly, it is little kept secret today that the monopoly railroads have no desire to move barley and will price these movements as high as needed to eliminate what would otherwise be competitive barley markets.

Loss of malting markets to Canadian competition. Again, allow me to illustrate real impacts resulting from the unrestrained market dominance by this country's railroads. Due to captive freight rates and substandard service, rail carriers effectively foreclosed any very real opportunities to move surplus malting barley from the Western U.S. to Upper Midwestern processing plants during the past three years, resulting in a 20 to 30 percent drop in prices and a 10 to 30 percent cut in contracted acreage in 2006. These U.S. malting markets were captured, instead, by our Canadian competitors, who enjoy lower rail rates in an environment where the railroads are regulated under regulatory caps. The movements from the malting producing areas in the U.S. are movements against the traditional flow. At first blush, it would seem that such an eastbound movement would produce a backhaul for rail cars headed back to the grain producing areas. However, the railroads are focused on shuttle trains and do not want to move shipments that do not conform to shuttle movement criteria even if it represents walking away from incremental business.

These wheat and barley examples underscore an economic model that encourages railroads to **dedicate their capacity and infrastructure improvements to intermodal movement at the expense of agricultural commodities**. This has been noted in numerous studies, including a GAO report issued in October 2007, *Freight Railroads – Industry Health Has Improved, But Concerns About Competition and Capacity Ought to Be Addressed*, GAO 07-94, available in full at http://www.gao.gov/new.items/d0794.pdf, that concluded those areas that are captive pay the highest freight rates yet receive some of the worst service.

During the 2003 car shortage, data produced by Burlington Northern Santa Fe (BNSF) showed that the most captive areas on BNSF system were singled out for the highest level of past due grain orders. This is illustrated in the chart below. Of the 22,147 cars that were past due, more than 70 percent of the past due orders were in the captive northern tier states of Montana, Minnesota, North Dakota and South Dakota, though this area of the country makes up less than 20 percent of that rail system. Rail cars are currently in April, 2008, being stored all over Montana and Idaho on abandoned or soon to be abandoned branchlines.



States With Rail Captivity Continue To Lose Economic Development Due to Rail Inadequacies

One of my major malting barley customers built a new malting plant in eastern Idaho five years ago to supply its Mexican breweries. After one and a half years of negotiation to find a competitive transportation relationship with the single railroad that served this area, the brewing vice president told the Idaho Governor in a meeting I attended that if the company knew when they planned to put this plant in Idaho what they know now about the effects of rail captivity, they would never have located in Idaho.

There have been many news reports in Idaho over the last few years of plant closings where the companies have publicly stated that one of the main reasons for shutting down have been high transportation costs. In the potato industry, Idaho supplied potatoes to the JR Simplot plant in Heyburn, Idaho (famous for McDonald French fries) for many years until the plant was shut down and moved to Canada, meaning the loss of hundreds of local jobs. Mr. Simplot told us the reason was high freight costs, and, indeed, most of the shipment of frozen and fresh potatoes in my area today has been forced to trucks.

In February, 2002, the FMC Corporation's closed its Pocatello, ID phosphorous plant, resulting in the loss of 440 jobs in an already economically depressed area of the state. The local newspaper cited rail as a primary reason for the plant closure according to FMC management, "Using the Monopoly game as an example, Paul Yochum detailed how delivery costs at FMC hurt the company. If you land on a railroad in Monopoly, you pay the owner $25. Unless he owns all four railroads, in which case you pay him $200. We once negotiated with several railroads, but following several buyouts, the number of (rail) owners plummeted and our negotiating leverage stopped." Yochum went on to add, "FMC's foreign competitors can pick from any number of shipping lines; we are at a significant disadvantage to foreign producers delivering goods."

Railroad Claims of Congestion and Capacity – Do The Studies Confirm This Capacity Shortage?

For several years now, the railroads have alleged that congestion and capacity constraints necessitate changes in rail regulation. The Surface Transportation Board, and Congress, have been told that the railroad industry no longer has excess capacity, and that the need for expanded capacity warrants limiting the recourse of captive shippers in numerous ways.

We believe these questions of rail congestion and capacity constraints should be closely examined. With so many issues of such importance hanging in the balance – not just the future of the common carrier obligation, but also fundamental issues of rate and service regulation and how much say railroads should have in how captive shippers operate – it is incumbent on the Congress to closely scrutinize the Railroads' claims.

I would call the Committee's attention to the recent ***Final Report of the National Surface Transportation Policy and Revenue Study Commission***. That Commission was established by Congress in the 2005 Highway Bill, SAFETEA-LU, and charged with assessing national infrastructure needs and options for meeting increased demand, including increased demand for freight transportation.

The Commission's Final Report supports the proposition that additional rail infrastructure funding is needed. However, when the Commission analyzed the railroad industry, its findings hardly supported a free hand for railroads with respect to raising prices or rejecting service requests or declaring near term failure in the rail system due to lack of adequate infrastructure. On the contrary, the Commission found, based on AAR data:

> "The Nation's freight rail network is relatively uncongested at current volumes of cargo (see Exhibit 3-8). Eighty eight percent of today's primary freight rail corridor mileage is operating below practical capacity. About 12 percent is near or at practical capacity, and less than 1 percent is operating above capacity." [Final Report pages 3-15]

Moreover, the Commission's findings appear to have been taken from the Cambridge Systematics report commissioned by the AAR, and those findings predate the current economic downturn, which is very likely to lead to overcapacity for railroads and other carriers. *Transport Topics* recently reported that BNSF has idled some 5% of its car fleet, parking upward of thousands cars in Montana alone, due to the current "freight recession."

The AAR has argued, and the Commission found, that rail capacity constraints may exist in the future. The Commission concluded that, by 2035, 54% of freight rail corridor mileage will be below or near capacity, 15% will be at capacity, and 30% will be above capacity. It is important to note, however, that these figures **ASSUME NO NEW CAPACITY IS ADDED IN THE NEXT 28 YEARS**. [Final Report pages 4-14]

In fact, as the Railroads frequently point out, they have a commendable record of capital investment. The Final Report finds that an average total investment of $5.3 billion per year is expected to be adequate to accommodate projected freight rail demand in 2035 to a point at which 98 percent of primary rail corridors operate at a level below their theoretical capacity. [Final Report pages 4-14]

As we have noted here today, there are well-known instances of railroads failing to meet service demands from grain shippers, as well as many other shippers. However, in view of the findings of the Final Report of the National Surface Transportation Policy and Revenue Study Commission, the Committee should not be too hasty in accepting the Railroad claims of urgent capacity and congestion problems warranting wholesale rationing of service or unimpeded pricing freedom.

Railroads' calls for reduced regulation based on alleged capacity constraints are not limited to rate issues. In STB Docket No. 42060 (Sub-No,. 1), North America Freight Car Association v. BNSF Railway Company, the Surface Transportation Board (STB) addressed the complaint of providers of private covered hopper cars and other cars used for transportation of agricultural commodities, who were challenging the decision of BNSF to end its long-standing practice of providing storage for empty private cars awaiting loading.

BNSF defended its decision to impose unprecedented charges for such storage unless shippers provide their own storage, or lease track from BNSF, or agree to contracts with substantial volume commitments, squarely on capacity grounds. See the BNSF Reply Statement filed September 16, 2005 at 40:

> In this case, the NAFCA Complainants had no basis for assuming that BNSF or any other railroad might not change their demurrage or storage charge practices with respect to empty private cars. The law is clear that they cannot claim reliance on BNSF's or any other railroad's past practice to carry their burden of proving "unreasonable practice" or a car service violation. This is particularly so in light of the

> necessity for BNSF and other railroads to address the circumstance in recent years of capacity constraints on their systems. The Board has made it a priority to encourage railroads to adopt new capacity-enhancing initiatives to meet the unprecedented demand for freight rail services from almost every sector of the shipping public. Change is not only expected by the Board, but demanded.

BNSF made these arguments despite the fact that (1) Class I railroads have forced shippers to acquire freight cars for <u>most</u> shipments of agricultural commodities (not just peak harvest volumes);[1] (2) poor rail service increases the need for rail cars; and (3) BNSF had the most aggressive storage charge program of any major railroad, and imposed its charges regardless of whether cars stored on its lines affected capacity or congestion.

Shippers need railroads to meet increasing demand for service. However, the Railroads' continuing call for reduced regulation is not the answer. Under reduced regulation, we foresee the likelihood of higher rates and charges, demands for shippers to provide services, equipment and facilities formerly provided by railroads, and outright refusals to provide service requested by shippers. This kind of rationing is generally called "demarketing" of rail service.

These developments represent a threat to the bottom lines of many shippers, particularly agricultural shippers who cannot reasonably pass these costs along. It is often claimed by proponents of deregulation that even railroads with monopoly power will not harm the interests of their customers. However, captive shippers provided evidence to the Surface Transportation Board in Ex Parte No. 665 Proceeding, <u>Rail Transportation of Grain</u>, that railroad monopoly practices have managed through pricing and service differentials to virtually eliminate grain elevators that do not load 100-car or more shuttle trains from effective participation in grain marketing. As a result, many grain producers must truck their grain farther to fewer elevators, and states like Colorado, Idaho, Minnesota, Montana, North Dakota, South Dakota, Oklahoma and Texas face greater costs and burdens for maintaining and expanding their highway systems.

Furthermore, railroads have been closing selected facilities where they do not want to continue to service, such as intermodal facilities. Many states that used to have multiple facilities for loading intermodal or transloading facilities have been forced to close such facilities because the railroads refuse to provide service to such locations. This consolidation is being forced upon shippers resulting in higher transportation costs to the shippers, but lower costs and less capacity demands on the railroad.

The Railroads are likely to argue they merely seek to maximize efficient operations, and that shippers have unrealistic expectations of more and better service without higher rates and charges. In fact, shippers support <u>reasonable</u> efficiency improvements, but

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1 Class I railroads provide only about one-third of the nation's covered hopper cars and <u>no</u> tank cars.

do not want railroads to be the sole arbiters of when service is provided and on what terms.

There is no sound public interest argument for railroads to look disproportionately to captive shippers to pay for capacity expansion so long as the contribution of non-captive traffic is not being maximized. And as a matter of law, the Long-Cannon amendment, 49 U.S.C. § 10701(d)(2), imposes further limits on differential pricing. Now that railroads have achieved or are attaining revenue adequacy, less reliance on differential pricing should be the rule even if additional revenues for infrastructure investment are required.

Conclusions

Agricultural growers together, with the members of the Alliance for Rail Competition, truly believe that a healthy and competitive railroad industry is essential for their continued viability. However, with poor service, a lack of available cars, increased rail rates and a regulatory agency that does not meet the needs of shippers, it is increasingly difficult for agricultural producers to remain competitive in a world marketplace.

It is clear, according in the ***Final Report of the National Surface Transportation Policy and Revenue Study Commission*** that rail capacity shortages may be overstated. We believe these questions of rail congestion and capacity constraints should be closely examined.

We believe that the government needs to be the facilitator and catalyst for increasing competition in this historically strong industry. We believe the railroad industry can survive and prosper in a competitive environment and, indeed, we know from history that competition breeds innovation and efficiency. The Alliance for Rail Competition, its member industries and the agricultural community believe the STB and its predecessor, the ICC, have failed to protect the interests of the captive rail shippers as the Staggers Rail Act intended.

As Congress works with the rail industry and shippers to address current and future infrastructure needs, we believe it is equally important to protect the interest of captive rail shippers. We call on this Committee to help us rebalance the monopoly practices of Railroads that seriously disadvantage captive shippers. Grain producers, along with members of ARC, believe that both railroads and shippers would be better off with more competition in the marketplace, and we strongly support provisions of HR 2125, a bill that calls for increasing competition without increasing regulation.

We believe this rail competition and infrastructure improvement legislation will improve rail transportation by providing fairness and openness in the negotiations between railroads and their customers over rates and service. By simply requiring railroads to provide rates to their customers between any two points on their system, many additional rail customers will gain access to the benefits of a competitive rail transportation system.

Thank you for this opportunity to testify today.

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